Senate Budget and Fiscal Review—Wesley Chesbro, Chair

SUBCOMMITTEE NO. 4 Agenda

Mike Machado, Chair
Tom McClintock
Christine Kehoe

Thursday, May 11, 2006
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Dave O'Toole

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VOTE ON VOTE-ONLY ITEMS:

<u>DISCUSSION ITEMS</u>

Control Section 8.50

Budget control section 8.50 of the Budget Act of 2005 encourages state agencies to maximize the use of federal funds and apply for more federal funds. This control section appropriates any new federal funds subject to the conditions set forth in Section 28.00 and other provisions of the Budget Act.

Department of Social Services Item 5180-403 governs the expenditure of funds from the Temporary Assistance for Needy Families (TANF) reserve. This item makes expenditure of TANF reserve funds subject to the notification requirements and conditions specified in Section 28.00.

The LAO has identified a concern with the Administration's current practice of using Section 8.50 to substitute TANF funds for other federal funds authority without legislative consultation. Although technically allowed under that item, the practice is in conflict with legislative intent expressed in Item 5180-403, which governs the use of the TANF reserve.

To clarify legislative control over TANF block grant funds after the budget has been enacted, the following amendment to Section 8.50 of the budget bill will indicate that substitution of TANF block grant funds for existing federal funds authority is subject to the same requirements set forth in Section 28.00.

> *(c) Paragraph (a) of this Section does not apply to federal Temporary Assistance for Needy Families (TANF) block grant funds. Any expenditure of TANF funds in excess of what is authorized in this act is subject to the notification procedures and requirements set forth in Section 28.00, Provision 4 of Item 5180-101-0001, or Item 5180-403, whichever is applicable.*

Staff Recommendation: ADOPT paragraph (c) by adding to control section 8.50.

VOTE:

0650 Office of Planning and Research

The Office of Planning and Research (OPR) assists the Administration with legislative analysis and planning, research, and liaison with local governments. The OPR also oversees programs for small business advocacy, rural policy, and environmental justice. In addition, the office has responsibilities pertaining to state planning, California Environmental Quality Act assistance, environmental and federal project review procedures, and overseeing the California Service Corps. The Governor's budget funds 72.3 positions and expenditures of $47 million.

1. Finance Letter: California Service Corps Volunteer Matching Database
The Administration requests that the Office of Planning and Research budget be increased by three positions and $1,140,000 General Fund in 2006-07, $1,203,000 in 2007-08, and $766,000 ongoing, to enable the California Service Corps to develop and maintain an Internet-based volunteer matching portal. This new service is intended to match volunteers with opportunities spread throughout California. The department believes this initiative will address California's low participation in volunteer opportunities relative to other states (46th in the nation) and the need for a centralized system to connect volunteers to opportunities.

The California Service Corps (CSC) has modeled the proposed web portal on the USA Freedom Corps web site (usafreedomcorps.gov), which consolidates volunteer opportunity data and directs the prospective volunteers to one of the main existing volunteer matching web sites, such as volunteermatch.com and 1-800volunteer.org or "hubs," such as local volunteer centers. The proposed portal will feature California opportunities exclusively, tying between 40 and 60 hubs in the state. In order to encourage up-to-date and accurate postings on the hubs, the CSC expects to sign quality assurance agreements with the organizations.

Staff Comment: This is not the first state-led effort of this kind. In 2001, the former Governor's Office of Service and Volunteerism (now the CSC) initiated a web site with a searchable database, a system that was discontinued in 2004 due to its search limitations, particularly a lack of volunteer opportunities. The proposed portal is intended to address those limitations, utilizing input from federal, state, local, education, and nonprofit organizations.

The BCP includes a substantial marketing component that will largely determine the success of the portal. Through a half million dollars in marketing in the first year, followed by lesser amounts in subsequent years, the OPR hopes to drive Internet users to the state portal, as opposed to one of the existing volunteer matching web sites.

Given that this is a new activity with some uncertainty over how the local agencies and nonprofits will respond, the Subcommittee may wish to fund the request for a limited period and review progress in a subsequent budget year.

Staff Recommendation: APPROVE the Finance Letter for two years and adopt the following budget bill language to Item 0650-001-0001:

No later than April 1, 2007, the Office of Planning and Research shall report to the Budget Committees of the Legislature on performance indicators for the Online Volunteer Matching Program. This report shall provide a status of the Program using information available to identify the number and name of volunteer programs who received volunteers referred by this system, web site hit count by month, number of posted volunteer opportunities by month, number of first-time volunteers, number of volunteer hours directly attributable to the statewide system, and other measures to fully disclose the impact of the Online Volunteer Matching Program.

VOTE:

0840 State Controller's Office

The State Controller is the Chief Financial Officer of the state. The primary functions of the State Controller's Office (SCO) are to provide sound fiscal control over both receipts and disbursements of public funds; to report periodically on the financial operations and condition of both state and local government; to make certain that money due the state is collected through fair, equitable, and effective tax administration; to provide fiscal guidance to local governments; to serve as a member of numerous policy-making state boards and commissions; and to administer the Unclaimed Property and Property Tax Postponement Programs. The Governor's budget funds 1,142.3 positions (including 54.7 new positions) and $27.8 million in expenditures.

VOTE-ONLY ISSUES

A. BCP: Apportionments Payment System

The SCO requests $776,000 (special funds) for a third year of funding to overhaul the state's Apportionment Payment System. The existing system has become dangerously overburdened and prone to breakdown, endangering a timely distribution of apportionments to local agencies. After this final year of system replacement, ongoing costs to maintain the system are expected to be $62,000. Funding for this activity is provided through a statewide budget item, Control Section 25.50.

B. Finance Letter: Human Resource Management System (HRMS)—21st Century Project

The SCO requests an augmentation of $35.1 million ($17.7 million General Fund) and 77.6 two-year limited-term positions to implement the design, development, and initial rollout phases of the HRMS. This request amends the Governor's Budget proposal by increasing the number of positions from 46.5 to 77.6 and decreasing General Fund expenditures from $20.1 million to $17.7 million, to reflect the final contract to be signed with the HRMS vendors.

Based on the contract to be signed, the total cost of the project will be $138.4 million, $60.9 million of which will be General Fund. This new total is $6.3 million over the previously assumed cost, identified in the feasibility study report. The project was first funded in 2003-04 and is expected to complete in 2009-10.

This workload is part of an ongoing multi-year project to replace existing employment history, payroll, leave accounting, and position control systems. The HRMS will also include a statewide time and attendance capability, greatly enhancing the Controller, Administration, and Legislature's fiscal oversight abilities. For example, it is expected that the system will eventually capture actual salary savings at each department, replacing the arbitrary five percent standard used statewide today.

VOTE on Vote-Only Issues A and B:

DISCUSSION ISSUE:

1. The California Automated Travel Expense Reimbursement System (CalATERS)

The SCO is currently implementing, maintaining, and rolling out the California Automated Travel Expense Reimbursement System (CalATERS), a computer system that automates the previously manual process of reimbursing state employees for travel costs. The benefits of using CalATERS include allowing state employees to submit travel claims easily, improved accuracy through automation, and centralized audits of travel rules and departmental policies. The CalATERS program began in July 2000 and has now been implemented in dozens of departments, affecting more than half of state employees.

Staff Comment: In the original Feasibility Study Report and in other budget documents filed since then, the SCO asserted that between $8 and $9 million in savings would be achievable by implementing CalATERS statewide. In the CPR, the SCO's staff identified a savings level of $9.3 million, noting that CalATERS reduces processing time from two weeks to five days for a typical expense claim.

While the department has encountered difficulties in quantifying savings to date in the partial rollout, process efficiencies have occurred in the administrative offices of department that have adopted CalATERS. In the SCO's office (where all travel claims must eventually go) claims audits and processing workloads have been streamlined, allowing SCO auditors to conduct more travel claim audits.

Notwithstanding the delays in recognizing savings, significant savings still appear achievable. According to the SCO, even though CalATERS has been rolled out with about half of state departments, approximately 80 percent of the claims they receive are still submitted by paper. If CalATERS were rolled out statewide, the SCO's auditing workload could decrease further and efficiencies gained, statewide, in travel reimbursement processes.

At the March 23, 2006, hearing, the SCO reported on the difficulty in quantifying savings achieved through this process and addressed the issue of implementing CalATERS on a statewide basis. A three-year grace period for full implementation will allow departments to phase in the system and adjust their budgets accordingly.

The following trailer bill language would effect a statewide rollout of CalATERS:

> *All state agencies shall utilize the California Automated Travel Expense Reimbursement System (CalATERS) by July 1, 2009.*

Staff Recommendation: ADOPT the trailer bill language above and implement CalATERS statewide.

VOTE:

0890 Secretary of State

The Secretary of State (SOS), a constitutionally established office, is the chief election officer of the state and is responsible for the administration and enforcement of election laws. The office is also responsible for the administration and enforcement of laws pertaining to filing documents associated with corporations, limited partnerships, and the perfection of security agreements. In addition, the office is responsible for the appointment of notaries public, enforcement of notary law and preservation of certain records with historical significance. All documents filed with the office are a matter of public record and of historical importance. The Secretary of State's executive staff determines policy and administration for Elections, Political Reform, Business Programs, Archives, and Information Technology and Management Services Divisions.

The Governor's budget funds 484.5 positions (including 31 new positions) and budget expenditures of $77.2 million ($32.0 million General Fund).

1. Help America Vote Act (HAVA) Spending Plan
In the fall of 2002, Congress passed, and the President signed, legislation to fund improvements to states' election systems. HAVA funds have been appropriated nationwide with the direction to implement broad election reforms and improve the accuracy and performance of each state's voting processes. For California, these activities include developing a statewide voter database, voter outreach, poll monitoring, replacing punch card voting machines with more modern equipment, and other related activities. Since establishment, California has received $352.2 million in federal funds to implement mandates affecting the administration of federal elections, and $9.3 million in interest earned. The 2005-06 budget reappropriated $252.9 million in federal funds for these purposes.

The 2006-2007 Governor's budget did not include the spending plan for the remaining HAVA funds previously approved by the legislature in April 2005. The DOF approved an interim HAVA spending plan from the Secretary of State on January 27, 2006. Based on concerns raised by the LAO, the Joint Legislative Budget Committee rejected this spending plan on March 1, 2006, and requested the Secretary of State and DOF revise the plan to address their concerns.

FINANCE LETTER AND REVISED EXPENDITURE PLAN
On April 18, 2006, the Administration submitted a Spring Finance Letter proposing $5.537 million in new budget year expenditures. Accompanying the Finance Letter is a revised expenditure plan for the $364 million in federal funds. This new plan (the April 2006 HAVA plan) would replace the HAVA expenditure plan approved by the Administration and Legislature in April 2005.

The new plan includes initial costs for the new statewide database ($2.1 million), the interim voter database ($344,000), redirected staff for database activities ($249,000), poll monitoring ($65,000), parallel monitoring ($342,000), voting system guidelines ($150,000), and voter education materials ($500,000). Additionally, the request includes reappropriation requests for $46 million in HAVA funds. The reappropriation will fund HAVA activities previously approved by the Legislature but behind schedule.

The plan components and total proposed spending amounts are:

- Punchcard Replacement ($57,322,706). The Secretary of State has received $57 million to meet a HAVA requirement that all punch card voting machines and voting systems be replaced by the first federal election of 2006 (June 6, 2006, for most counties). There are no expenditures for this activity in the budget year.

- Registration Application Requirements ($590,000). The Secretary of State proposes to spend $590,000 in the current year on voter registration cards. The Secretary of State will print 10,000,000 new registration cards this year and take non-compliant and outdated voter registration cards out of circulation. This expenditure represents a reduction of $521,000, relative to the April 2005 plan. The Secretary of State reports that the additional cards will no longer needed.

- Election Assistance for Individuals with Disabilities Grants ($3,345,629). These noncompetitive grants are allotted to counties and administered by the Department of Health and Human Services. These funds are intended to improve accessibility and participation in elections by persons with disabilities.

- Accessibility, Accountability, and Accessible, Voter-Verifiable Paper Audit Trail (AVVPAT) ($195,000,000). Federal HAVA section 301 requires an AVVPAT, notification of over votes (when a voter selects more candidates than permitted), and other measures to improve accountability in elections. These funds will be administered by the Secretary of State to counties and will involve the Secretary of State certifying all voting systems for use and ensuring compliance by counties with HAVA requirements.

- Poll Monitoring ($130,000). The Secretary of State proposes $65,000 in the current year and budget year to fund staff travel, housing, and incidentals, for three days during election periods. This funding request is a discretionary activity not explicitly directed in the HAVA legislation.

- Parallel Monitoring ($897,000). The Secretary of State proposes expenditures of $342,000 in the budget year for contract services for development of testing methodologies, testing, and video services associated with parallel monitoring of election systems. This testing process is intended to supplement the current logic and accuracy testing process that occurs *before* a system is certified.

- Statewide Database (VoteCal) and Interim Solution of Existing Database (CalVoter) ($74,230,976). The Secretary of State proposes expenditures of $2.7 million in 2006-07 for a multiyear project to establish a statewide voter database and implement an interim statewide voter database. Section 303 of HAVA requires that states set up and maintain a computerized statewide voter registration list containing the name and registration information of every legally registered voter in the state. The Secretary of State will spend $344,000 in the budget year to establish and operate the “interim solution,” a series of technology upgrades and process changes necessary to attain interim compliance with HAVA database requirements.

- Adherence to Voluntary Voting System's Guidelines and Processes ($200,000). The Secretary of State proposes expenditures of $150,000 in the budget year for activities related to implementing Voluntary Voting System Guidelines recently issued by the federal Election Assistance Commission and adopting other regulations pursuant to the new guidelines.

- Voter Education Development and Dissemination ($800,000). The Secretary of State proposes expenditures of $500,000 in the budget year for voter education activities to include brochures and other printed material, support for community groups involved with voter outreach, staff outreach, and Voter Bill of Rights costs.

- Administration ($7,011,000). The Secretary of State proposes expenditures of $1.7 million in the budget year to fund a total of 10 positions for work associated with administering HAVA funds. Budget year expenditures will be documented via time sheets and billed to federal HAVA funds, creating an equal General Fund savings to be captured at the end of the budget year.

- Reserve Fund ($7.6 million). The Secretary of State's April 2006 HAVA plan includes a reserve fund of $7.6 million for unanticipated costs, including the VoteCal database project.

The following activities were eliminated from the April 2005 HAVA plan:

- Federal Auditing Requirements (-$1.5 million). The Secretary of State asserts that these funds are not specifically needed, given the HAVA auditing activities already conducted by the Bureau of State Audits, federal auditors, and the Secretary of State. If future problems at the county level warrant a new state audit, the Secretary of State will request additional funding.

- Source Code Review (-$1.2 million). The Secretary of State's April 2006 HAVA plan does not include funding for review of voting system's source code, peripheral devices such as access card encoders, precinct-based scanners and central vote tabulating devices. The Secretary of State reports that federal testing labs are responsible for this activity and that other states will perform additional systems testing, the results to which California will have access. The Secretary of State believes that independent testing will be needed only on a very limited basis and in those cases will be paid for by the vendor, who will contribute to an escrow fund for this purpose.

- County Training Grants (-$9.5 million). The Secretary of State proposes the removal of all funding for voter education and training of local officials and poll workers. The department has determined this to be a discretionary HAVA activity. Some of the voter education and training will be funded out of the $195 million for accessibility, accountability, and AVVPAT activities, identified above.

Staff Comments:

SOURCE CODE REVIEW
Source code review has been funded in prior versions of the HAVA plan on the basis that this was an important activity that conformed to the Voting Systems Security Act of 2004 (SB 1376, Chapter 813, Statutes of 2004), which provided the Secretary of State authority to access to ballot tally source codes and take other steps to ensure elections are conducted appropriately.

The absence of funding for source code review raises significant concerns regarding vulnerabilities of our voting systems. While the federal government may be conducting tests of voting systems, the results of federal testing are confidential between them and the vendor. The state is only told whether a system passed or failed.

The Secretary of State has explained that finding independent contractors for this service can be difficult. Notwithstanding that difficulty, the Secretary of State has located contractors in the past, in particular with source code review of Diebold systems.

Certification is an ongoing process and funding for state testing must be available. New systems are still being proposed—particularly those intended to satisfy HAVA's disabled voter access requirements—and existing systems are regularly modified, a process that necessitates recertification. The Secretary of State should commit sufficient source code review resources to make this happen.

There is currently $40,000 in the escrow account established for source code review. The addition of $760,000 for this purpose will fully fund source code review in the budget year.

EXPENDITURE AUTHORITY
The LAO has raised concerns with the proposed budget bill changes and recommended the changes below. These amendments would reject specific reappropriations from the Budget Act of 2004 that were proposed by the Department of Finance and instead specify amounts to be spent in the budget year for state operations purposes.

> *0890-001-0890--For support of Secretary of State, for payment to Item 0890-001-0001, payable from the Federal Trust Fund for the implementation of the Help America Vote Act. . .~~1,745,000~~ $6,297,023*
> *Provisions:*
> *1. Funds shall be expended for the purposes approved in the April 11, 2006 Help America Vote Act spending plan. The amounts spent on each activity shall not exceed the maximums specified in the spending plan. In addition, that spending plan is amended to include $760,000 for source code review in 2006-07, as described in the March 11, 2005, expenditure plan and consistent with Chapter 813, Statutes of 2004..*
> *2. Notwithstanding any other provision of law, any funds not needed for an activity authorized in the spending plan shall not be redirected to other activities and are not authorized for expenditure.*
> *3. The Secretary of State shall forward to the Chairperson of the Joint Legislative Budget Committee copies of quarterly reports sent to the Department of Finance. The quarterly reports shall provide, at a minimum, the level of expenditures by scheduled activity.*

4. The Department of Finance may authorize an increase in the appropriation of this item, up to the total amount of the program reserve. Any such approval must be accompanied by the approval of an amended spending plan submitted by the Secretary of State providing detailed justification for the increased expenses. No approval of an augmentation or spending plan amendment shall be effective sooner than 30 days following the transmittal of the approval to the Chairperson of the Joint Legislative Budget Committee, or not sooner than whatever lesser time the chairperson of the joint committee, or his or her designee, may determine.
5. Notwithstanding any other provision of law, any primary vendor contract for the development of a new statewide voter registration database shall be subject to the notification and other requirements under Section 11.00 of this act. The validity of any such contract shall be contingent upon the appropriation of funding in future budget acts.

0890-495, Reversion, Secretary of State. As of July 1, 2006, all unencumbered funds from the following appropriations shall revert to the Federal Trust Fund for future use to implement the Help America Vote Act:
(1) Item 0890-001-0890, Budget Act of 2004 (Ch. 208, Stats 2004)
(2) Item 0890-101-0890, Budget Act of 2004 (Ch. 208, Stats 2004)
(3) Item 0890-490, Budget Act of 2005 (Ch. 38, Stats 2005)

Staff Recommendations:
1. ADD $760,000 (federal funds) to carry out source code review as described in the March 11, 2005, HAVA plan.

2. ADOPT the LAO-proposed budget bill language.

VOTE:

1730 Franchise Tax Board

The Franchise Tax Board (FTB) administers state personal income tax and corporation taxes for the State of California, collects debt on behalf of other state agencies and local entities, and performs audits of campaign statements and lobbyist reports authorized by the Political Reform Act of 1974. The FTB is tasked to correctly apply the laws enacted by the Legislature; to determine the reasonable meaning of various code provisions in light of the legislative purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view. The Governor's budget funds 5,160.4 positions (including 32.5 new positions) and expenditures of $662.4 million ($499.2 million General Fund).

VOTE-ONLY ISSUE

Finance Letter: California Child Support Automation System (CCSAS) State Disbursement Unit Increase for Reimbursements
The Administration requests that the FTB main budget item, 1730-001-0001, be amended to increase reimbursements by $256,000 ($87,000 General Fund, $169,000 Federal Trust Fund) to enable the Franchise Tax Board to execute a contract related to the CCSAS Project. Specifically, these reimbursements would be used to enter child support wage withholding information in the Child Support Enforcement system for customers who do not receive public assistance and have not requested enforcement services of the state.

VOTE on Vote-Only Issue:

DISCUSSION ISSUES

1. Tax Credit, Deduction, Exclusion, and Exemption Reporting

OVERVIEW
Credits, deductions, exclusions, exemptions (also known as tax expenditures) are breaks given to certain business entities or groups of people with the assumption that larger societal or economic benefits will be achieved. Regular and ongoing review and evaluations of credits, deductions, exclusions, and exemptions could make the state's tax system more efficient and effective—both at achieving economic and social goals and raising revenue.

California's credits, deductions, exclusions, and exemptions encourage behavior among a broad range of entities, from rice straw growers to renters and students to stock owners. These tax credits may be particular to California or they may also be "conforming" credits, deductions, exclusions, and exemptions that extend federal credits, deductions, exclusions, and exemptions to the state level (e.g., the student loan interest deduction). They may be targeted to relieve undue fiscal stress from one group of people or incentives a particular behavior for another.

The most common concerns arising from the use of credits, deductions, exclusions, exemptions are that they may necessitate an increase in tax rates or a cut in expenditures, complicate the tax code, induce undesirable behavior, reduce policy flexibility, or provide windfalls to targeted groups who no longer merit the benefit. Alternatives to tax expenditure programs include reducing general tax rates, mandating a program, direct government regulations, and direct expenditures.[1]

REPORTING

The proliferation of credits, deductions, exclusions, and exemptions in the tax code, combined with dynamic nature of the state's economy, underline the need for sound analysis of the efficacy of tax expenditures.

Tax expenditures reflect incentives for a certain business, industry or behavior at a certain point in time and may become less valuable overtime, leading to a significant tax incentive for a specific entity with little economic impact. In addition, they can complicate the tax code by subsidizing grant like programs and ultimately reduce policy flexibility, hindering the Legislature and Administration from taking corrective action or simplifying tax code. By their very nature, tax expenditures can increase the general tax rate necessary to fund the operations of the state. As they grow, the state increases revenue volatility by tightening its tax base.

Current reporting on credits, deductions, exclusions, and exemptions is provided by the BOE, FTB, and DOF. The BOE prepares a *Sales and Use Taxes: Exemptions and Exclusions* report that provides a brief description of sales and use tax credits, deductions, exclusions, and exemptions and an estimate of revenue lost, if readily available. The BOE does not have resources to estimate revenue loss for all sales and use tax credits, deductions, exclusions, and exemptions. The FTB periodically prepares a *California Income Tax Expenditures Compendium of Individual Provisions*, which provides a more detailed description of the personal income and corporation credits, deductions, exclusions, and exemptions with revenue known revenue losses. Known revenue losses in FTB's 2005 report were based on 2001 data. DOF has a statutory requirement to report on credits, deductions, exclusions, and exemptions as specified in Government Code Section 13305:

> *13305. The department shall provide an annual report to the Legislature on tax expenditures. The report shall include each of the following:*
> *(a) A comprehensive list of tax expenditures.*
> *(b) Additional detail on individual categories of tax expenditures.*
> *(c) Historical information on the enactment and repeal of tax expenditures.*

That latest report from DOF (2005-06) identifies annual state revenue losses of approximately $25.3 billion from credits, deductions, exclusions, and exemptions. This includes:

- Personal Income Tax: $21 billion
- Sales and Use Tax: $270 million
- Corporation Tax: $4 billion

Additionally, the credits, deductions, exclusions, and exemptions for property tax and for the local share of sales and use tax are estimated to cost $7 billion annually. These credits, deductions, exclusions, and exemptions matter to the state because they create a fiscal cost to the state in terms of backfilling Prop 98 funding.

[1] Franchise Tax Board, *California Income Tax Expenditures: Compendium of Individual Provisions,* 2005.

Altogether, 2005-06 revenue losses from credits, deductions, exclusions, and exemptions were approximately $32 billion.

Recognizing the inconsistent reporting, as well as the many billions in revenue associated with these programs, the Legislature should consider developing greater attention to credits, deductions, exclusions, and exemptions, through the following three objectives: (1) understanding their intentions and implications, (2) gaining better access to information, and (3) revising and enhancing reporting. The following measures would pursue those three goals:

Objective 1: Understanding the intentions and implications of tax expenditures

This objective will be met through supplemental report language exploring the policy basis, intent, and practical success of several tax expenditures.

> ***Tax Expenditure Program Reporting.*** *The Legislative Analyst's Office (LAO) shall report to the Chair of the Senate Committee on Revenue and Taxation, the Chair of the Assembly Committee on Revenue and Taxation, and the Chair of the Joint Legislative Budget Committee no later than March 15, 2007, and October 1, 2007, regarding tax expenditure programs (TEPs). The report shall provide information selected individual TEPs such as credits, deductions, and other special tax provisions, and be based, in part, on data provided by the Board of Equalization, Employment Development Department, Franchise Tax Board, and other applicable state agencies, as requested by the LAO. The report shall also provide information, when available, on all newly enacted credits, deductions, exclusions, and exemptions. The number and nature of the individual TEPs reviewed in each report shall be determined by the LAO, taking account of workload considerations and in consultation with the Revenue and Taxation Committee of each house of the Legislature. To the extent possible, the reports shall, for each TEP involved: (a) describe the TEP; (b) discuss the program's rationale or objective; (c) identify the statutory, constitutional, or other authority for the program; (d) identify the program's cost in terms of forgone revenues, (e) describe the program's distributional impact on taxpayers by income, gross receipts, or other suitable measure; (f) assess the program's effectiveness and cost-efficiency in meeting its original intent; (g) evaluate the program's impact on taxpayer behavior; and (h) provide recommendations for repealing, modifying, establishing a sunset, or continuing indefinitely, each tax expenditure,. If no clear statutory objective exists, the report shall include suggested legislative changes to establish an objective for the tax expenditure program.*

Objective 2: Improving oversight of existing tax expenditure programs

This objective will be met through joint policy or budget hearings held during the interim period to review the tax expenditures analyzed by the LAO. These hearings would cover the findings from the SRL described above and also include:

1. BOE and FTB testimony on the rationale for tax expenditures that the LAO suggests may no longer fulfill their original intended purpose.
2. Suggested alternative policy measures to achieve the statutory objective of the tax expenditure (if one exists) or the identification of a policy objective for the tax expenditure.
3. Metrics for meeting the statutory objective of the tax expenditures examined by the LAO.

Objective 3. Revising and enhancing reporting

This objective will be met by revising the existing Government Code 13305 reporting requirements to include:

1. A reporting date of February 15 each year.
2. Limit the reporting to tax expenditures of $5 million or more.
3. Statutory authority for each credit, deduction, exclusion, and exemption.
4. Description or restatement of the Legislative intent for each expenditure (if specified in legislation).
5. Sunset date, if applicable.
6. A brief description of the beneficiaries of the credit, deduction, exclusion, or exemption.
7. Estimate or range of estimates for the state and local revenue loss for the current fiscal year and the two subsequent fiscal years. For SUT, this would include partial year exemptions and all other tax expenditures where the BOE as obtained information.
8. For PIT tax expenditures, the number of taxpayers affected and returns filed (as applicable) for the most recent tax year for which full year data are available.
9. For CT and SUT tax expenditures, the number of returns filed or business entities affected (as applicable) for the most recent tax year for which full year data are available.

Tax expenditures should also be evaluated during the budget enactment process. This comparison will facilitate a more comprehensive assessment in order to identify wasteful, ineffective, or outdated tax programs.

Staff Recommendation: ADOPT Objectives 1 (Supplemental Report Language) and 3 (trailer bill language implementing Objective 3).

VOTE:

2. Finance Letter: California Child Support Automation System (CCSAS) Augmentation Language

The Administration requests that budget bill language be added to FTB main budget item 1730-001-0001 to authorize the Director of Finance to approve any augmentation for unanticipated CCSAS project expenses that are deemed necessary to meet federal certification requirements or immediately necessary for system functionality. All other CCSAS augmentations would be subject to standard 30-day legislative review. This language will provide a mechanism to address unanticipated costs associated with the CCSAS project and to accommodate very short project timelines.

Staff Comment: The language provides that "if the Director of Finance deems that the augmentation is in the critical path to meet federal certification requirements and therefore necessitates immediate action or immediately necessary for system functionality, the Director may approve the augmentation. Any changes for these purposes would be excluded from the reporting requirements of Section 11.00." In such a case, written notification would be required to the Legislature within 10 days *after* Finance approval of the contract. If those conditions are not met, project augmentations would be authorized after a 30-day advance notice to the Legislature. Language is also requested to allow $132 million in federal funds in the 2006-07 budget to be available for expenditure through 2007-08.

The LAO has also expressed concern that the Budget Bill Language would limit Legislative authority. This request represents an unusual and not apparently necessary delegation of project authority to the Administration. A prudent alternative would be to amend the budget bill language to (1) ensure Legislative oversight prior to mid-year spending increases, and (2) limit the amount of funding and time period for mid-year increases.

Senate Subcommittee #3 has already acted on March 27, 2006, to amend the budget bill language to make those changes (3-0 vote).

Staff Recommendation: AMEND the budget bill language for Item 1730-001-0001 to (1) ensure Legislative oversight prior to mid-year spending increases, and (2) limit the amount of funding and time period for mid-year increases.

VOTE:

1760 Department of General Services

The Department of General Services (DGS) provides management review and centralized support services to state departments. The DGS is responsible for the planning, acquisition, design, construction, maintenance, and operation of the state's office space and properties. It is also responsible for the state departments' procurement of materials, communications, transportation, printing, and security.
The Governor's budget funds 3638.8 positions (including 12 new positions) and expenditures of $1.05 billion.

VOTE ONLY ISSUES

A. Finance Letter: Centralized Printing and Mail Services for the Statewide Child Support System
The Department of General Services requests $4.4 million in 2006-07, $6.5 million in 2007-08, and $9.4 million in 2008-09 to carry out printing and mail services for the Department of Child Support Services. A printing and mailing service provider is needed to comply with federal directives on collection of child support payments and prevent federal penalties due to noncompliance. At full implementation, the department expects to print over 22 million pages per month. The proposed augmentation will enable DGS to upgrade its existing printing capabilities and improve service to state and non-state clients.

B. Finance Letter: Inspection Verification Services at Gambling Facilities
The Department of General Services requests $50,000 from the Indian Gaming Special Distribution Fund and a redirection of $40,000 from the Architectural Revolving Fund for construction and inspection verification services at tribal gaming facilities. DGS asserts that gambling compacts enacted in 1999 and 2003 between the state and tribes compel them to conduct construction inspection verifications services. DGS will redirect 0.3 personnel years from Department of General Services Real Estate Services Division to this activity.
The following budget bill language would authorize the requested activity:

> *1760-001-0367—For support of the Department of General Services, for payment to Item 1760-001-0666, payable from the Indian Gaming Special Distribution Fund……..$50,000.*

C. Finance Letter: Prison Construction Inspection Staffing for San Quentin Condemned Inmate Complex
The Department of General Services requests to reduce staff by 9.4 personnel years and $1.3 million (Architectural Revolving Fund) in 2006-07 to reflect delays in construction of the San Quentin Condemned Inmate Complex.

D. Budget Change Proposal: State Relocatable Classroom Program
The Department of General Services requests an appropriation of $74,000 from the State School Building Fund and one position to implement a phase-out of the state's relocatable classrooms. The proposal also includes a request to shift the funding source for this activity from bond funds to the State School Building Aid Fund. The Department has determined that obtaining a relocatable classroom lease from private industry are lower than the costs of rehabilitating the existing classrooms.

VOTE ON VOTE-ONLY ISSUES A THROUGH D:

DISCUSSION ISSUES

1. BCP: Building Security Augmentation at State Buildings

At the April 6, 2006, hearing, the Subcommittee considered an augmentation to the Department of General Services budget for increased security costs at five state buildings. These additional expenses were based on reduced service commitments by the CHP at the Ronald Reagan building and other minor cost increases at four other state buildings. DGS will fund these security augmentations through an assessment on building tenants.

The state has no standard security requirement for its buildings: however, the California Highway Patrol may provide a security assessment and recommendation. Departments ascertain by themselves what the best level of building security is for their facility, or, in buildings with multiple tenants, all tenants collectively decide to increase their facilities needs. DGS then prepares a cost estimate and presents it to the tenants.

Requests for security augmentations since 9/11 have occurred on a piecemeal basis and there is neither a minimum, nor a maximum, level of expenditures that a department may devote to building security. Security enhancements can be very expensive. It has been estimated that outfitting all state-owned buildings with x-ray scanners would cost between $40 and $50 million. To the extent that departments do enhance their building security, they either absorb the cost or request an augmentation.

The following budget bill language would require the DGS to survey departments on their pre and post-9/11 security expenditures and identify key cost drivers and expenditure trends over that period.

> *The Department of General Services shall collect information from all state departments in the Executive Branch on all state-owned and leased buildings (office space) with a minimum 50,000 square feet to determine the nature and level of security expenditures for fiscal years 2000-01 through 2005-06. Information collected shall include, for each facility meeting the above criteria: (1) annual expenditures on facility security, (2) annual expenditures on non-state security personnel, (3) identification of any security-related budget augmentation requested during that period, (4) indication of whether a California Highway Patrol security assessment was performed on the facility, (5) identification and cost of any building security-related equipment purchased costing more than $5000 during that period, (6) facility location, (7) description of programmatic activities performed at the facility, and (8) a narrative explanation for increased costs during that period. The Department shall provide this information to the Department of Finance, the Legislative Analyst's Office, and the Budget Committees of the Legislature no later than March 15, 2007.*

Staff Recommendation: ADOPT the budget bill language in the Department of General Services budget.

VOTE:

2. Strategic Sourcing Update
Strategic Sourcing is a joint partnership effort to leverage the State's buying power to facilitate bulk purchasing. The Administration's Strategic Sourcing concept involves analyzing what the state is buying, market conditions, and potential suppliers, and then leveraging purchases for the best deal.

One way in which DGS has recognized savings was through the establishment of State-defined standard for technology, also known as common configurations. The state's Chief Information Officer Council selected these configurations, a first in the state's history of IT procurement. The common configurations are expected to simplify technical support, streamline processes, and create greater interoperability.

Control Section 33.50 of the 2005 Budget Act provides the current statewide authority for the Administration's Strategic Sourcing initiative. That control section states the following:

> *SEC. 33.50. Notwithstanding any other provision of law, the Department of Finance is authorized to periodically reduce amounts in items of appropriation in this act for the 2005-06 fiscal year to reflect savings resulting from California's Procurement Initiative for the 21st Century. The Director of Finance shall notify the Chairperson of the Joint Legislative Budget Committee at least 30 days prior to reducing any item of appropriation. The notice shall include, but is not limited to: (a) identifying which department received the savings; (b) identifying when and how the savings were achieved; (c) identifying the types of goods and services as to which savings were achieved; and (d) describing the methodology used to calculate the savings.*

This current year budget language is not included in the 2006-07 budget bill and no current year savings have been identified by the Department of Finance.

Staff Comments:
UNSUBSTANTIATED SAVINGS
In the 2005-06 Governor's Budget, the Administration assumed that it could generate $96 million in savings in 2005-06. This target was later eliminated in the 2005 Budget Act, in part because the Administration recognized that any savings realized could be better used by departments to meet their $100 million in unallocated reductions target for the current year.

According to DGS, expected savings from Strategic Sourcing are estimated at $171 million over the next three years. Savings are expected to occur across multiple categories, including office supplies, computers, servers, copiers, and pharmaceutical purchases. However, these savings are hard to confirm, largely because of the difficulty in verifying that identified Strategic Sourcing savings might not have otherwise occurred.

The perspective that Strategic Sourcing savings could be used by departments to meet their $200 million in unallocated reductions for the budget year has again been suggested by the Administration. Were it possible to verify their existence, then certainly identifiable savings from contracts would be a more straightforward way to recognize departmental savings, as opposed to the current blanket $200 million unallocated reduction.

While savings have been minimal and difficult to verify, the intent of the current year budget bill language remains valid and should be preserved as a means to identify strategic sourcing savings, in particular as they offset unallocated reductions.

A better means to apprise the Legislature of Strategic Sourcing savings would be to have DOF report to the Legislature on amounts paid to the CGI-AMS contract and reduce appropriations as contract payments are made. According to the contract, DGS must pay CGI-AMS approximately 10.5 percent of the realized savings.

The current contract with the Strategic Sourcing vendor runs through June of 2007. The department has not decided whether to extend the contract or to rely on staff to manage procurement contracts themselves. Given the lack of a proven and identifiable savings figure, the Legislature should carefully evaluate any attempt to extend a Strategic Sourcing contract.

The following budget bill language would tie these payments to reductions in appropriations and allow the Legislature to review the contract for Strategic Sourcing, if continued.

> *SEC. 33.50.*
> *(a) Notwithstanding any other provision of law, the Department of Finance may periodically reduce items of appropriation in this act for the 2006-07 fiscal year for savings tied to California's Procurement Initiative for the 21st Century. The Director of Finance shall report quarterly to the Chairperson of the Joint Legislative Budget Committee on payments made to the contractor hired for the Procurement Initiative for the 21st Century and at least 30 days prior to reducing any item of appropriation. The quarterly report and notice on reducing appropriations shall include, but is not limited to: (a) identifying which department received the savings; (b) identifying when and how the savings were achieved; (c) identifying the types of goods and services as to which savings were achieved; and (d) describing the methodology used to calculate the savings.*
>
> *(b) Any joint partnership contracts in support of California's Procurement Initiative for the 21st Century shall be executed no sooner than 30 days after written notification has been provided to the Joint Legislative Budget Committee.*

SINGLE SOURCE SUSCEPTIBILITIES

Strategic Sourcing and common configurations raise important questions regarding the state's ongoing efforts to avoid an Oracle-type procurement situation. In 2002, the state had made a major investment in Oracle software and hardware and in doing so forced itself into buying only Oracle-compatible software and hardware for its IT needs. With no other vendors available, the state faced extremely high costs for products without competitor.

To better understand the state's single-source susceptibilities, the Subcommittee should ask the following questions:

State’s Chief Information Officer/Department of General Services:

1. How are departments overseen or advised to prevent an Oracle-type situation from happening?
2. What is considered the minimum number of bids (if any) for all IT procurements?
3. What is the state’s overall IT procurement plan and how is it developed?
4. What is the role of the state’s CIO?
5. What does DGS or the CIO do to ensure that systems proposed by different agencies that need to communicate with each other are capable of doing so?
6. Does DGS or the CIO coordinate each proposal to help the state realize greater savings by packaging bids?

Department of Finance:

1. What is DOF’s role in overseeing IT procurements of all sizes and types?
2. How has the “sole-source trap” been addressed since the Oracle scandal?
3. What steps has DOF taken to prevent an Oracle-type situation from developing again?

Staff Recommendation:

1. Direct the Department of General Services and Department of Finance to respond to the single source procurement questions raised above.

2. Adopt staff’s Control Section 33.50 (above).

VOTE:

8620 Fair Political Practices Commission

The Fair Political Practices Commission has primary responsibility for the impartial administration, implementation, and enforcement of the Political Reform Act of 1974. The objectives of the Political Reform Act are to ensure that election campaign expenditure data is fully and accurately disclosed so that the voters may be fully informed and to inhibit improper financial practices, and regulate the activities of lobbyists and disclose their finances to prevent any improper influencing of public officials.

The Governor's budget proposes 73.4 positions (including 14 new positions) and expenditures of $7.002 million in 2006-07. Between 2004-05 and 2006-07, FPPC staffing is expected to grow by 30 percent, from 56.8 positions to 73.4 positions.

Staffing Augmentation for Increased Workload

The Governor's budget includes $700,000 General Fund and 12.2 positions to meet workload requirements stemming from new Legislative mandates and the Political Reform Act. Caseloads and backlogs have increased considerably in recent years: in the enforcement division, new cases nearly doubled from 892 in 2003 to 1751 in 2004. The requested positions will be assigned to enforcement, investigations, legal counsel, legal support, and administrative support. Revenues in the range of $90,000 to $120,000 are expected from enforcement actions.

Staff Comment: The BCP request did not include an operating expense (OE) complement. Without this funding, the department would have to either absorb or request at a later date the communications, computer equipment, data support, furniture, and other items normally accompanying new positions. At staff request, the FPPC modified their request to recognize an appropriate level of OE. The same number of positions are requested, however, the position classifications have been adjusted slightly to recognize $43,000 in OE.

At the April 26, 2006, hearing, this issue was left open to explore the appropriateness of this level of augmentation.

Staff Recommendation: AMEND the proposal to recognize the $43,000 OE complement. (This amendment will result in no change to overall cost or number of positions.)

VOTE:

8855 Bureau of State Audits

The Bureau of State Audits promotes the efficient and effective management of public funds and programs by providing independent, objective, accurate, and timely evaluations of state and local governmental activities to citizens and government. By performing financial, performance, and investigative audits, and by performing other special studies, the State Auditor provides the Legislature, the Governor, the Milton Marks Commission on California State Government Organization and Economy ("Little Hoover Commission"), and the citizens of the state with objective information about the state's financial condition and the performance of the state's many agencies and programs.

The Governor's budget proposes 139.5 positions and expenditures of $13.019 million in 2006-07.

1. Staffing and Audits Augmentation
The Bureau of State Audits (BSA) requests $1.2 million General Fund in 2006-07 and 2007-08 to address recruitment and retention challenges and to contract out portions of the annual federal compliance audit for at least two years (an optional third year will be considered).

The BSA has encountered significant staffing losses recently—including the loss of nine of 18 audit supervisors over the last year—and requests a salary realignment to better retain staff. Without experienced staff, the BSA's ability to meet a growing Joint Legislative Audit Committee-directed workload is diminished.

Many of the supervisory staff and several other lower-level staff have moved to other public agencies and the private sector where pay and benefits are comparatively better. To address this problem, the State Auditor has proposed and received approval from the State Personnel Board to realign auditor classifications and adjust salaries and benefits to align with other comparable state agencies.

At the same time, the BSA has encountered a spike in the number of large audits requested by the JLAC. Without additional staffing, the BSA cannot respond to all requests. The BSA proposes to respond to the spike in the number of large audits requested by the JLAC by contracting out the portions of the annual federal compliance audit, at an annual cost of $2.5 million for two years. (A third year will be considered in 2007-08.) The BSA will redirect from prior year savings and shift money from the State Audit Fund where prudent, but some General Fund support is also needed.

Staff Recommendation: APPROVE the $1.2 million General Fund augmentation for two years.

VOTE:

8860 Department of Finance

By statute, the Director of Finance serves as the Governor's chief fiscal policy advisor with emphasis on the financial integrity of the state and maintenance of a fiscally sound and responsible Administration. The objectives of the Department of Finance are to: (1) prepare, present, and support the annual financial plan for the state; (2) assure responsible and responsive state resource allocation within resources available; (3) foster efficient and effective state structure, processes, programs, and performance; and (4) ensure integrity in state fiscal databases and systems.

Vote-Only Budget Issues:

A. Reappropriation of Budget Information System (BIS) project funding (BCP #1)

The administration requests to expend the balance of the $1.7 million appropriated in the 2005 Budget Act through June 30, 2007. This action is requested for the purpose of completing the chart of accounts (COA) and procurement acquisition assistance activities for the BIS. This action is necessary because under advisement from the Department of General Services, the procurement strategy has changed, resulting in extension of timelines for completion of this portion of the project.

Detail: The purpose of the BIS is to streamline budget processes and develop a year-round integrated budget system to replace the multiple legacy budget systems. The State currently lacks a single integrated system for development of the annual budget and for other financial functions, such as accounting and procurement. Existing systems are more than 25 years old and require significant staff support to maintain. These systems, used today to produce the Governor's Budget and other key budget documents, were first developed in the 1970s to capture the incremental changes to the budget.

In order to ensure compatibility between the BIS and any other departmental or statewide management systems that may be developed, the DOF would like to develop a universal "chart of accounts" to be used by all such systems. Future funding beyond this request will be contingent upon approval of a Budget Change Proposal for 2007-08.

B. Trailer Bill Language for Changes to the Fiscal Integrity and State Managers' Accountability Act (FISMA)

Description: The DOF is proposing to amend the Government Code requiring agencies to: (1) conduct an internal review and submit a report on <u>a biennial basis</u> but no later than December 31st of each odd-numbered fiscal year pursuant to the Fiscal Managers Accountability Act (FISMA); and (2) <u>require a corrective action plan be provided to Department of Finance within 30 days after the report is submitted, with updates due every six months until corrective actions have been completed.</u>

Background. Current law requires that the head of each agency prepare and submit a report on the adequacy of the agency's systems of internal accounting and administrative control by the December 31st of each odd-numbered fiscal year. FISMA, Government Code 13400–407, requires each state agency to maintain effective systems of internal accounting and administrative controls. Furthermore, FISMA defines internal controls and requires agencies to evaluate controls continuously. When weaknesses are detected, they are to be corrected promptly. To ensure FISMA compliance, agency heads must certify to the agency's internal controls biennially. The act also discusses the Department of Finance's (DOF) responsibility for guiding agencies in their reviews and reporting. DOF requires all state entities to submit reports concluding on the adequacy of their organization's internal controls. The reports consist of a certification letter, internal control audit report(s) and management's response to the audit report(s). To help agencies fulfill FISMA requirements, DOF issues an audit guide for the evaluation of internal controls and, when necessary, issues audit memos to establish uniform policy and procedures.

Neither FISMA nor the State Administrative Manual (SAM) establishes enforcement responsibilities or sanctions. As a result, DOF has limited its monitoring and coordination to recording the state agencies which file their certification letters and audit reports. In the past, DOF performed more internal control audits of agencies without internal auditors. However, due to continuing budgetary constraints, DOF has refocused its efforts to emphasize reimbursement work and has discontinued many of its FISMA related audits unless requested and paid for by the agencies.

Staff Comment: According to DOF, the current requirement that the report be submitted in the odd-numbered fiscal year limits the timeframes to complete the reviews. The amendment allows more flexibility regarding when FISMA reviews can be conducted and reports submitted. In regards to the corrective action plans, FISMA states that state agency heads are responsible for the establishment and maintenance of a system or systems of internal accounting and administrative control within their agencies. Currently there is no requirement that agencies submit corrective action plans or updates related to correction of material weaknesses to Department of Finance. As a result many of the internal control reports contain the same findings each reporting year. To ensure that agencies are implementing changes to correct material weaknesses, it is proposed to add a requirement for corrective action plans.

VOTE on Vote-Only Issues A and B:

DISUCUSSION ISSUES

ISSUE 1: Mandates Unit (BCP# 2)

Description: The Governor's budget requests 4.0 positions (3.8 personnel years) and an increase in reimbursement authority ($537,000) from Item 8885-295-0001 to establish a Mandates Unit with DOF to address and coordinate local government mandate activities and develop, examine, investigate / evaluate, and implement policies and procedures to be used to reform the reimbursable mandates process and create methods to conduct activities required of DOF. It is expected the efforts of this unit will ultimately result in providing timely and appropriate mandate costs estimates to the Legislature while such bills are being considered by the Legislature.

Background: The DOF is required to perform a number of activities related to mandates, including:

- ✓ Preparation of a cost estimate of a bill during the legislative process, if Legislative Counsel keys the bill as a mandate;
- ✓ Annually review and report on enacted legislation resulting in costs, revenue losses, or cost savings;
- ✓ Provide analyses on test claims including providing written recommendations and testifying at Commission on State Mandates (CSM) formal hearings, and participating in informal meetings and pre-hearing conferences;
- ✓ Provide oversight on activities required by the State Controller's Office (SCO) relating to mandate costs and payments;
- ✓ Identify in the Governor's Budget, mandates that are suspended or deferred;
- ✓ Develop and include in the Governor's Budget, the full payable amount not previously paid for all mandates for which the costs have been determined in a preceding fiscal year unless the costs were incurred prior to the 2004-05 fiscal year;
- ✓ Develop and include in the Governor's Budget, an amount to fund mandate costs incurred prior to the 2004-05 fiscal year not previously paid.

Currently, budget units at Finance are responsible for mandate analysis and determination activities. Typically such bills and test claims are assigned to the most closely related program area. For example, mental health mandates are assigned to Budget Staff responsible for the Department of Mental Health. Also, the responsibilities related to mandates for budget development are not assigned to a single coordinating unit. The mandate budget development activities are in addition to regular departmental program budget workload. The proposed mandate unit within Finance would be charged with identifying policy issues in the current mandate payment process, conducting analyses of the issues and proposing solutions. Finance also proposes to provide a greater level of direction over the State Controller's Office (SCO) activities to ensure reimbursement is provided in an efficient and prudent manner. Finance is not currently staffed to provide such oversight and direction.

Recommendation: Staff recommends approval of the request, but rather than funding from reimbursements out of the local assistance mandates claims item, it should be funded directly from the General Fund since any short /intermediate/long-term benefits of enhanced mandate analysis and review will accrue to the General Fund.

VOTE:

ISSUE 2: eBudget Presentation System Maintenance and Knowledge Transfer (BCP #3)

Description: The Governor's budget requests $135,000 in additional General Fund to support the ongoing maintenance, corrections and fixes of the eBudget presentation system. Of the funding requested, $104,000 is one-time for web design consulting services and $31,000 in ongoing funding for data processing and data center costs.

Background: Prior to January 2000, the Governor's budget and summary were only provided in print form. Since January 2000, in addition to hard bound copies, these documents have been made available on DOF's web sit in a portable data file (PDF) format. In January 2004, in an effort to reduce the publication costs, the Governor's budget was provided on CD-ROM rather than the traditional hard bound volume. In the Budget Act of 2004, the Legislature authorized through Control Section 4.45, a $750,000 transfer from the Department of General Services to the DOF for costs associated with producing the Governor's budget through electronic or other media and printed hard copies as necessary. In continued support of the web-based presentation, the Budget Act of 2005 provided 1.8 Personnel Years (PYs) and $484,000 General Fund for the evaluation, and continuing development and enhancement of the Governor's Budget Presentation System. In addition, the Legislature provided authority to continue the contract with a web development firm through the end of 2005-06 and increase the contract by $250,000.

Staff Recommendation: Approve the administration's request with additional clarifying language to Provision 4 to ensure that the Legislature be provided any subsequently proposed amendments or modifications to the Governor's proposed budget, typically prepared in April and May Revise, in hardcopy form.

VOTE:

ISSUE 3: Trailer Bill Language for Fiscal and Performance Oversight of Proposed Strategic Growth Plan

Description: The administration proposes to add trailer bill that would require the Director of Finance, as he or she deems necessary, do both of the following: (1) ensure that performance and outcome measures are developed for all programs and projects funded with bond issued to implement the Strategic Growth Plan (SGP); and (2) audit the programs and projects funded with bonds issued to implement the SGP. And no later than September 30 of each year, the Director shall prepare and submit to the Governor a report on the results of these audits for use in the budget process.

Background: In his State of the State address on January 5, the Governor presented an infrastructure proposal, known as the Strategic Growth Plan. The plan laid out the initial 10 years of a 20-year objective to focus on the state's infrastructure needs in the areas of transportation, K-12 and higher education, flood control and water supply, public safety, the courts, and other miscellaneous program areas. According to the Administration, phase one (2006-2014) of the plan projects more than $220 billion in infrastructure expenditures -- of this amount, $68 billion will be financed with General Obligation (GO) bonds.

Staff Comment:
The discussion on bonds whether through the SGP or Legislature has been moved to a conference committee on this subject matter, and any additionally required oversight should be dealt with in that committee.

It is not clear that existing state staff and working groups could not accomplish the same objectives as this proposal. In the 2005 Budget Act, the Legislature approved a DOF request of 3.0 positions (2.9 personnel years) to among other things, centralize the expertise for the ongoing bond oversight, increase monitoring, conduct departmental training, and fund retainer contracts with financial advisors and bond counsel.

Staff Recommendation: Reject the trailer bill language.

VOTE:

8885 Commission on State Mandates

The Commission on State Mandates is a quasi-judicial body that makes the initial determination of state mandated costs. The Commission is tasked to fairly and impartially determine if local agencies and school districts are entitled to reimbursement for increased costs mandated by the state. The Governor's budget funds 14 positions (with no new positions) and expenditures of $243.4 million.

The budget includes $241.6 million ($240 million General Fund) to local governments for mandate costs. That sum contains the following five components:

- Payment of $48 million for 35 mandates.
- Payment of $45.7 million for mandates still to be identified for payment in the budget year.
- Deferment of payment for the Peace Officers Procedural Bill of Rights Mandate, mandate estimated to cost $35 million in the budget year.
- An appropriation of $50 million for mental health services to special education students (the AB 3632 mandate) with the express intent that the mandate be converted to a categorical program.
- An appropriation of $98.1 million for the first year of a 15-year repayment cycle for past due state mandate claims.

Twenty-eight mandates are recommended for suspension in the budget year.

1. New Mandates Cost Calculation (LAO Issue)
Proposition 1A requires that the annual state budget include funding for the prior-year costs of new mandates (that is, those mandates recently approved by the commission). The administration has budgeted $45.7 million for these prior-year costs. At the time this analysis was prepared, the commission had adopted a statewide cost estimate for only one new noneducation mandate, totaling $142,000.

Our review also indicates that it would be advisable for the Legislature to enact legislation clarifying the state's procedures for including funds for new mandates in the annual state budget. Absent such legislation, Proposition 1A could be interpreted as requiring the state to include funds for a mandate approved on the very last day of the fiscal year. To give the Legislature and administration a reasonable amount of time to adjust the annual budget bill to include funding for new mandates, we recommend the Legislature specify in statute that funds to pay the statewide cost estimate of a new mandate adopted after March 31 would be included in the budget for the *subsequent* fiscal year.

> *Government Code § 17561.*
> *(c) (1) Except as specified in (2), for purposes of determining the state's payment obligation under Article XIII B, Section 6 (b) 1, a mandate "determined in a preceding fiscal year to be payable by the state" shall include all mandates for which the commission adopted a statewide cost estimate pursuant to Section 17600 of the Government Code during a previous fiscal year or that were identified as mandates by a predecessor agency to the*

commission, unless the mandate has been repealed or otherwise eliminated.
(2) If the commission adopts a statewide cost estimate for a mandate during the months of April, May, or June, the state's payment obligation under Article XIII B, Section 6 (b) shall commence one year later than specified under (1) above.

Staff Comment: At the March 23, 2006, hearing, the Subcommittee held this issue open to allow staff to determine if an additional month would be prudent (to February 28 or 29) in order to capture the cost of new mandates. An additional month is not necessary and would degrade the quality of estimates.

Staff Recommendation: ADOPT the proposed trailer bill language identified above**.**

VOTE:

2. More Information About Mandates in Budget
The LAO has noted that the 2006-07 Governor's Budget and 2006-07 Budget Bill provide less information than previous budget documents and treat K-12, community college, and non-education mandates inconsistently. The Governor's budget, for example, provides no mandate-specific information regarding noneducation mandates and little information regarding community college mandates. The administration's changes to the state's budget documents make it exceedingly difficult for the Legislature or local agencies to understand the administration's proposals or track the Legislature's decisions regarding mandates over time.

Staff Comment:
An obstacle to accurate reporting of past year mandate costs in the Governor's Budget (which would also allow better current year and budget year estimates) is the final claiming date for reimbursable costs.

Government Code Section 17560 generally prescribes that a local agency or school district may, by January 15 following the fiscal year in which costs are incurred, file an annual reimbursement claim that details the costs actually incurred for that fiscal year. For example, the final date to file claim costs for the 2004-05 fiscal year is January 15, 2006. This late date precludes past year actual amounts from being included in the Governor's Budget, released on January 10.

In order to provide more accurate and timelier cost information to the Legislature, the Subcommittee should shift the final mandate claiming date to three month's earlier. An October 15 deadline should allow enough time for the SCO's final auditing of claims and DOF to include actual past year numbers and more accurate current year and budget year estimates in the Governor's Budget.

Staff Recommendation: ADOPT trailer bill language shifting the final mandate claiming date from January 15 to October 15.

VOTE:

3. Clarification of Mandate Payment Period

Government Code Section 17617 specifies that past due non-education mandates shall be paid over a period of up to 15 years, beginning with the 2006-07 fiscal year. Recently, questions have been raised regarding this code section and the state's obligation to pay off mandate debt. To clarify the state's obligation, budget bill language is needed to ensure the appropriation in the Commission on State Mandates budget may be expended only to the extent authorized by the statutory scheme (i.e. for approved claims rather than court judgments), and subject to the statutory limit on the payment of interest.

Staff Comment: The following budget bill language, amended as shown below to provision 1 of 8885-299-0001 of the pending Budget Bill, would provide the necessary clarification.

> 1. Allocations of funds provided in this item to the appropriate local entities shall be made by the Controller in accordance with the provisions of each statute or executive order that mandates the reimbursement of the costs, and shall be audited to verify the actual amount of the mandated costs in accordance with subdivision (d) of Section 17561 of the Government Code. Audit adjustments to prior year claims may be paid from this item. ~~Funds appropriated in this item may be used to provide reimbursement pursuant to Article 5 (commencing with Section 17615) of Chapter 4 of Part 7 of Division 4 of Title 2 of the Government Code.~~ *The funds appropriated by this item shall be allocated only for the payment of claims as required by Chapter 4 (commencing with Section 17550) of Part 7 of Division 4 of Title 2 of the Government Code, which payment shall be made pursuant to Article 5 (commencing with Section 17615) of that chapter. Notwithstanding any other provision of law, interest shall be paid from funds appropriated by this item only to the extent, and in the amount, authorized by Section 17561.5 of the Government Code.*

Staff Recommendation: AMEND Item 8885-299-0001 as displayed above.

VOTE:

8940 MILITARY DEPARTMENT

The Military Department is responsible for the command, leadership and management of the California Army and Air National Guard and five other related programs. The purpose of the California National Guard is to provide military service supporting this state and the nation. The three missions of the California National Guard are to provide: (1) mission ready forces to the federal government as directed by the President; (2) emergency public safety support to civil authorities as directed by the Governor; and (3) support to the community as approved by proper authority. In addition to the funding that flows through the State Treasury, the Military Department also receives federal funding directly from the Department of Defense.

The Governor's budget funds 685.9 positions (including 17 new positions) and $111.5 million in expenditures ($38.1 million General Fund, $62.0 federal funds, and $11.4 in other funds and reimbursements).

VOTE-ONLY ITEMS

A. Roseville Armory

The Department of the Military requests $2.525 million General Fund to implement the construction phase of the Roseville Expansion and Renovation Project. The federal government will contribute $881,000 to this phase of the project. The total anticipated project cost is $5.993 million, of which $3.052 million is General Fund and $2.941 million federal funds.

Provisional language is necessary to enable this transfer:

4. *Funding provided in Schedule (2.5) of this item will be matched by $881,000 federal funds. These funds do not flow through the Treasury of the State of California because they are paid by the Department of Defense directly to the US Army Corps of Engineers for the purpose of management and execution of these projects. Thus, the federal contribution to this project will not be reflected in the Budget Act.*

B. Reappropriation for Minor Capital Outlay Projects

The Department of the Military requests budget authority to reappropriate funding for the department's minor capital outlay projects (e.g. kitchen, latrine, and lighting upgrades) funded in the Budget Act of 2005. The Military Department utilizes the Army Corps of Engineers to design and manage these projects. Due to Hurricane Katrina some of these personnel have been diverted to Gulf states and project schedules have slipped.

Provisional language is necessary to enable this reappropriation:

8940-491—Reappropriation, Military Department. The balance of the appropriation provided in the following citation is reappropriated for the purposes and subject to the limitations, unless otherwise specified, provided for in that appropriation:

0001—General Fund

(1) Schedule (2) of Item 8940-301-0001, Budget Act of 2005 (Ch. 38, Stats. 2005) for 70.90.004-Minor Projects

Vote on Vote-Only Items A and B:

DISCUSSION ITEMS

1. Finance Letter: Second Youth Challenge Program
The Administration requests $3.9 million ($900,000 General Fund) and 17.8 positions in 2006-07, and $3.3 million ($1.4 million General Fund) and 29 positions in 2007-08 to establish a second Youth Challenge Program that will serve at-risk 16 – 18 year-olds who have dropped out of school, are unemployed, and meet other criteria. The Military Department received a one-time federal appropriation of $1.7 million to develop facilities to support a new 200 person complex. The federal government will contribute $1.9 million ongoing for this program.

The U.S. Congress established the Youth ChalleNGe program in 1992 to address a burgeoning problem with school drop-outs. The first Youth ChalleNGe Program was established in California in 1998 at Camp San Luis Obispo. That program currently accepts 300 students a year in two classes (150 per class), and graduates about 100 per class. (Students drop out for various reasons, including drug use, violation of camp rules, or voluntarily.) Student placement data shows that since inception, between 67 and 91 percent of program graduates have returned to school and/or gone into full-time employment.

The department currently turns away approximately 400 students annually from Camp San Luis Obispo due to insufficient class space. The new facility at Los Alamitos would alleviate some of the demand by accepting 200 students a year.

Staff Comment: At the April 26, 2006, hearing the Subcommittee requested information from the department regarding the geographic and socio-economic background of candidates, application process, and basis for this request coming through the budget process.

The department has clarified the urgency for requesting the establishment of the second Youth ChalleNGe program through the budget process. First, the existing program was reviewed and authorized through the budget process. Second, the availability of a federal match for this program (approximately three-to-one match in the first year), suggests the Legislature decide whether to expand the Youth ChalleNGe program during the budget process, before federal funds could potentially be lost or reallocated.

Staff Recommendation: APPROVE the Finance Letter.

VOTE:

9860 Capital Outlay Planning and Studies Funding (Discussion Issue)

This budget item provides funding to be allocated by the Department of Finance to state agencies to develop design and cost information for new projects.

A key capital outlay project appeal process has come under Legislative scrutiny this year as it relates to Government Code Section 13332 and reporting requirements for project scope changes.

1. Government Code Section 13332.11 requires that augmentations in excess of 10 percent of the amount appropriated for each capital outlay project shall be reported to the Chairperson of the Joint Legislative Budget Committee (JLBC), or his or her designee, 20 days prior to board approval, or not sooner than whatever lesser time the chairperson, or his or her designee, may in each instance determine. While not apparently intentional, in some recent cases, this has not occurred and JLBC approval was not obtained beforehand.

2. The Administration has approved several project scope changes that appear to have been made to keep a proposed project augmentation below the 20 percent limit, above which Legislative action is required. It is not clear that the Administration's actions are consistent with statute or full disclosure to the Legislature.

Staff Recommendation: Request the Department of Finance respond to the two issues described above and suggest statutory changes that may be necessary to fully conform to existing requirements without unnecessarily impeding capital outlay projects.